DOW THEORY LETTERS INC.

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36 Letters per Year — $75 Annually

Registered with the Securities Exchange Commission

May 14, 1971 Letter 496

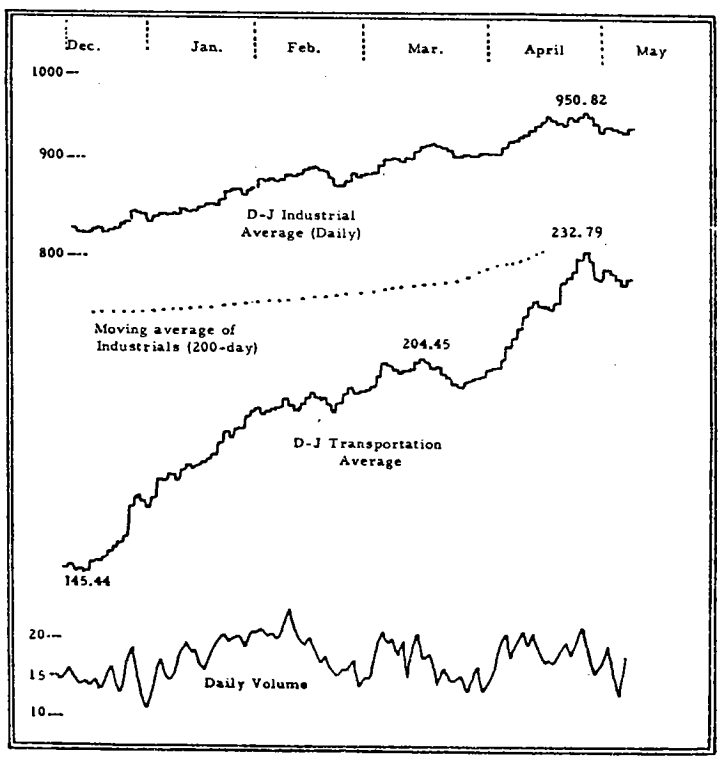
I have been publishing Dow Theory Letters for 14 years (since 1958) without a real vacation. My doctor says that I am a fool not to take a vacation and I agree. Therefore, with the permission of my loyal subscribers I am going to take a rest for about three weeks, and the next Letter should come out in early June - a letter which I hope will be better than ever.

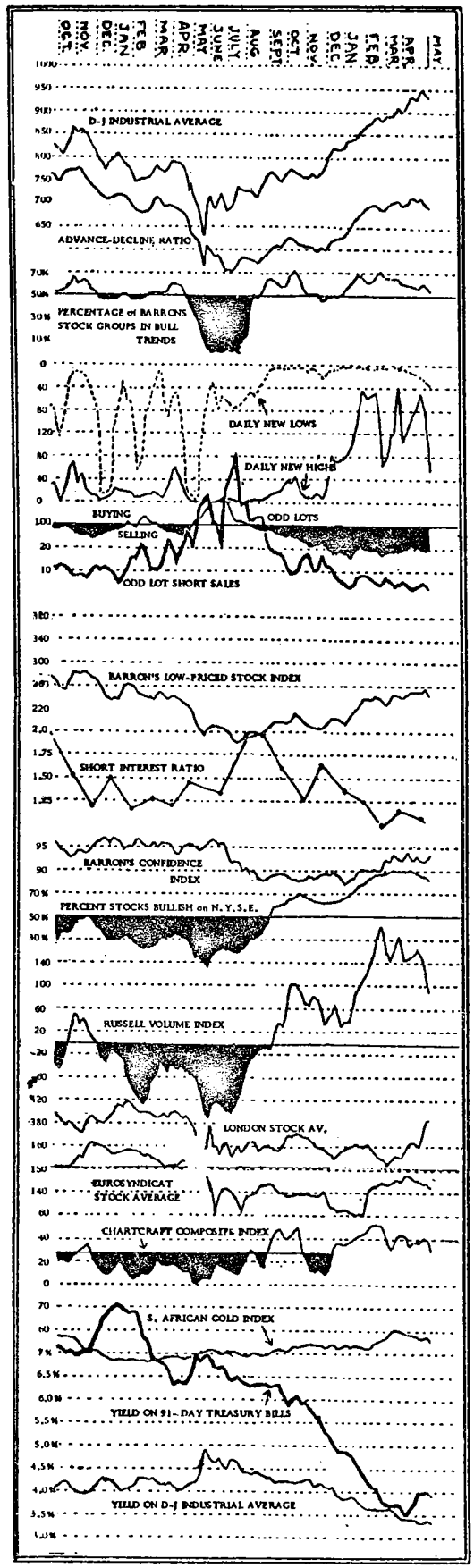
In the meantime, short - stop monetary gimmicks are the order of the day, dissention is taking over our creditors in the common market, the once mighty dollar is now the "sick currency" of the Free World, and other countries have "floated" their currencies against the dollar in the hopes that the flight from the dollar will at least be temporarily halted.

But "temporary" is the key word. The real fundamentals are the U.S. budget deficits, the U.S. inflation, and the cynical ignorance of our political leaders. Until they are settled, the crisis will continue.

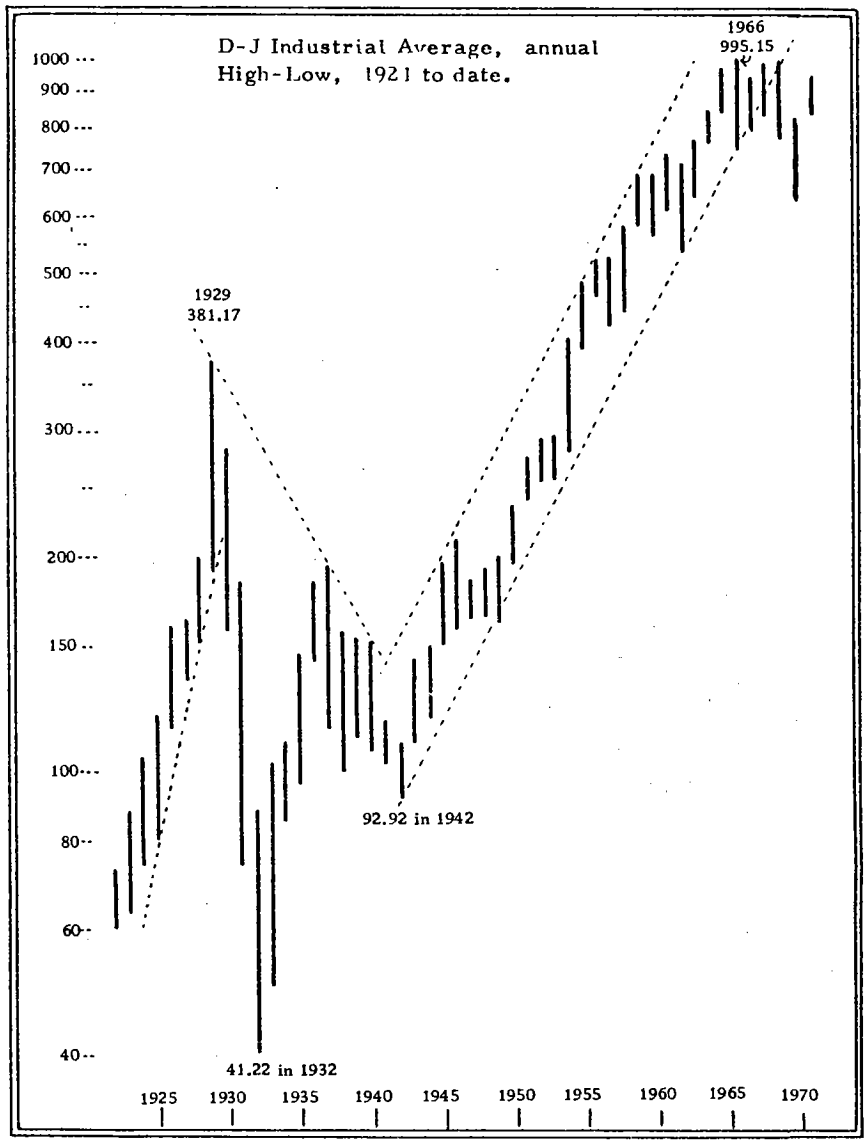
In the end, during the next few years, I believe the U.S. and the world will be pulled into a giant, deflating depression. Then, the dirty water, which so far has only been seeping out from under the closet, will become an ocean of problems and disasters. Slowly, relentlessly, 25 years of short-sidedness, disregarded warnings and fatuous hopes are coming home to roost.

BIG PICTURE: This is my annual high-low range chart (see page 2) of the D-J Industrials, covering the period of 1922 to date. While filling in the year 1971 to date, I was fascinated with the structure and the range of the last nine years. For as one studies the chart, it becomes clear that the 1966 top of 995.15 and the 1970 low of 631.16 have described a top and bottom range





that have included all the years since 1963. In other words, the Dow has fluctuated between 995 and 631 for the past nine years, and it is of further interest that during the years 1969, 1970 and 1971 this whole range was traversed twice.



It is more interesting when we realize that during the nine years of the 995-631 range, the U.S. has encountered one of its most virulent and persistent periods of inflation. Those who insist that inflation "is good for stocks" might ponder this. For almost a decade of wild inflation the Dow has been locked into the range shown on the chart while the majority of stocks on the N.Y.S.E. are lower now than they were at their 1966 peaks.

The giant rise since 1942 has been presented on the chart in the form of a rising channel formation. The channel was terminated in 1969 when the Dow fell below the lower channel limits for the first time in 25 years. The year 1970 saw the Dow plunge far below the lower limits, and this year (1971) sees the Dow struggling back towards the 1966 high but still far outside the channel limits.

To my mind, the Market is now (and has been since 1966) in the process of forming a major descending channel. This new formation will serve to correct the rising channel in both duration and extent. Note that despite massive Government efforts to keep the market rising, despite massive inflation and expansion of the money supply in the U.S., the Dow seems to be straining against superior forces which at best have the effect of "making the roof bigger" (see chart) or broadening the current top formation.

As a rule, the bigger the top, the greater the ultimate decline.

BUSINESS: I read a great deal in all "directions", and as far as I can see there is only one economist who is saying that business is in trouble, and that is Eliot Janeway (see profile, front page of May 3 Wall Street Journal). In the opening paragraphs of that article, Janeway is quoted as follows: "The economy is like a shot-up fighter plane trying to get back from a mission. Fuel is pouring out the bullet holes, and the way it's going it won't have enough speed and altitude to make the runway. It's heading for a crash, so get out of the way".

As far as I can see, there is only one nationally-circulated periodical that is saying that business is in trouble. That publication is Dun's. In the latest (May) issue, Dun's states that its Dun's President's Panel (a collection of top industry executives) "have been waiting patiently for the economy to make its long-expected recovery. They are still waiting — with little optimism". Then follows a series of quotes from various presidents and chairmans of the board, the gist of which is that easier money and a step-up in depreciation schedules "have had a limited effect on their businesses, while rising costs and inflationary labor demands remain the biggest barriers to a full economic recovery".

I have stated before that my own personal guess regarding the business picture is that business would have a slow first quarter, 1971, the second (current) quarter would see a further slight pick-up, and that the second quarter would actually be the best quarter of the year. I expect business to become increasingly worse during the third and fourth quarters of 1971!

A few readers may have noticed that during April foreign auto sales jumped to 16% of total sales, highest ever, and this with the U.S. supposedly offering competition with their own mini-cars. Last week U.S. Steel announced price raises of 6% on sheet and strip steel, raises that covered about one third of all their shipments. A few people might also have noticed this little clip regarding business failures, a clip which was buried towards the middle of last week's Wall Street Journal.

Business Failures Set High For 3 Years in April 29 Week

NEW YORK – Commercial and industrial failures spurted to 273 in the week ended April 29, the highest casualty count since May 1968, Dun & Bradstreet Inc. said.

The week before, the business reporting company counted 190 failures. There were 214 in the corresponding 1970 week.

For the year to date, Dun & Bradstreet totaled 3,888 business casualties, up from 3,514 a year earlier.

MONETARY DIARY:

Monday, May 3: Paul McCracken (Pres. Nixon's top economic advisor) stated that there are "heartening signs that the worst may be over" in the outflow of short-term capital from the U.S.....U.S. Government bonds off sharply with the bellwether 4¼ of 1987-92 closing at 76.2 bid. Gold closes at $39.43, down 28¢ from Friday.

Tuesday, May 4: The dollar plunges in foreign markets. In three hours the West German Central Bank was forced to buy $1.2 billion to keep the exchange rate of U.S. money from collapsing. George Schultz (U.S. Director of the Budget) meanwhile stated that our top priority is the U.S. economy, not our international monetary problems. Chancellor Brandt of Germany told a political rally that the Government would do "what was necessary" despite any criticism. He said it would not serve the European community to bring the German house down. In a later statement Schultz said that the U.S. Federal budget deficit from the year ending June 30 will be "noticeably larger" than the $18.6 officially forecast. He said the $11.6 billion deficit planned for fiscal 1971-72 might also have to be revised upwards. U.S. Treasury bonds sold off sharply with the 4¼ of 1987-92 closing at a low for the year of 75.8 bid. Gold closed at $39.86 in London, a high for the year.

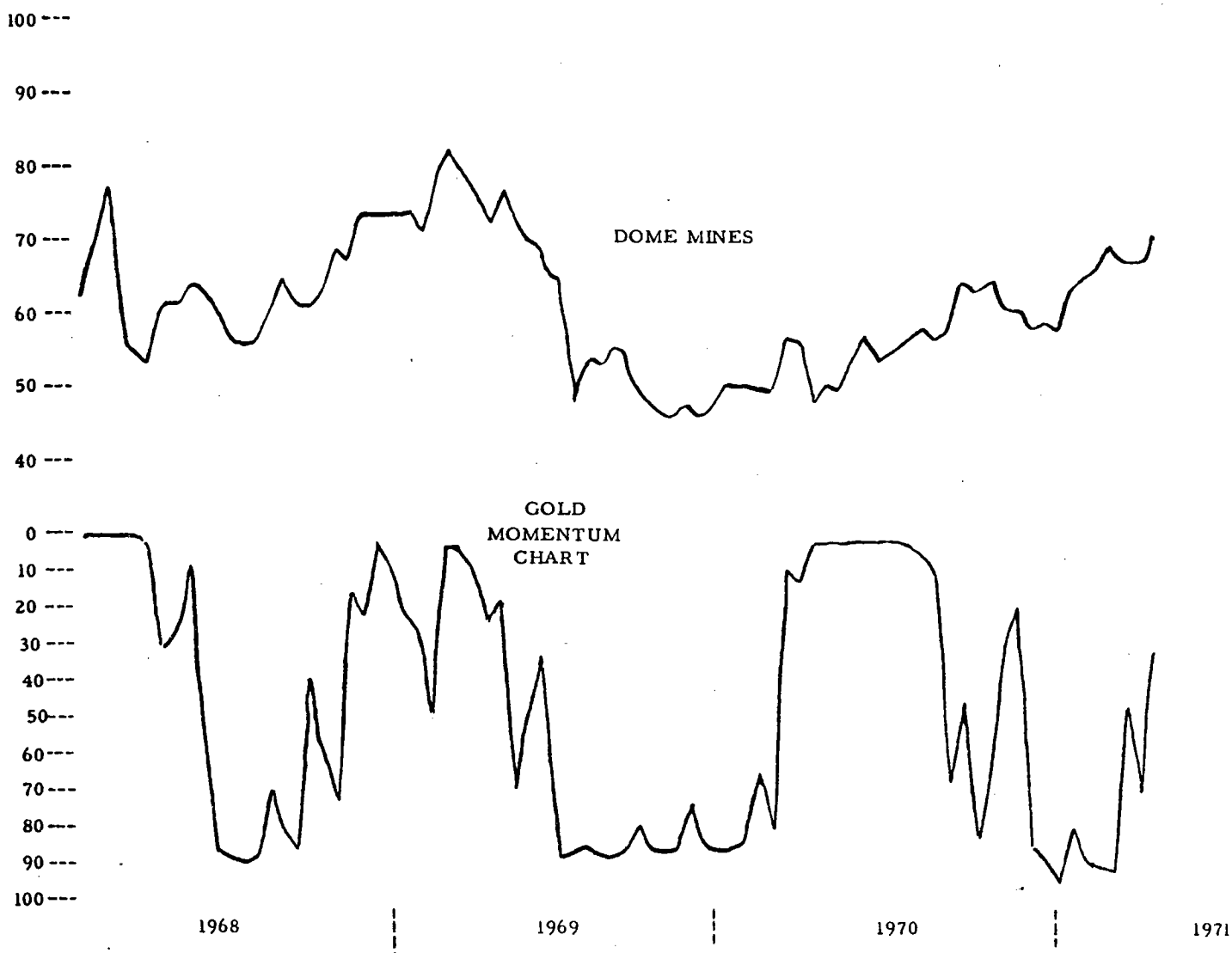
Wednesday, May 5: After absorbing $1 billion in the first hour, Germany suspended support purchases of dollars. Other major European central banks followed. The gold price rose to an 18-month high of $40.10. Prices of key commodities soared as frightened investors sought havens for their money. The Federal Reserve bought an estimated $1 billion in U.S. Government bonds in an effort to support the jittery bond market. German Chancellor Brandt promised action Friday (May 7) on the crisis. Campbell, Dome and Homestake (gold mine shares) all hit new highs for the year.

Friday, May 7: Gold closes in London at $40.30, a new high. The West German government stated that it would not revalue the mark upwards although it might allow the mark to "float" free against the dollar. West German business pressure against revaluing the mark was intense, since revaluing would put German goods at a disadvantage while making imports to Germany more attractive. In Washington, the rise in wholesale prices accelerated as inflation continued on its rampant path. The wholesale price index rose a seasonally adjusted .5% or at a rate of 6% annually. Industrial prices rose by the same amount. Secretary of the Treasury Connally said of the wholesale price index, "I don't think we should pay too much attention to it". President Nixon prepared to ask Congress for a $250 mil. loan guarantee to keep Lockheed in busine In an incredible statement, Secretary Connally stated that the dollar crisis was a result of "speculation", not a failing on the part of the U.S.

Week-end, May 9-10: Germany's mark to float free. Switzerland, Austria revalue. Unemployment in U.S. rises to 6.1%. Treasury refunding of maturing Securities fails badly. Business executives oppose Lockheed bail out.

Monday, May 11: Mark rises 3.6% in value, but Japan's yen is under pressure, and Japanese businessmen get nervous as they are faced with a change in the value of the yen.

GOLD CYCLES: The accompanying chart (page 4) shows the price of Dome Mines (top), a leading gold mine holding company. This is superimposed upon the Chartcraft Gold Momentum Index. Each week Chartcraft arranges the 98 Standard & Poor stock groups in order of price momentum. The momentum is based on a 17-week cycle. The strongest group each week will be numbered 1, the weakest will be numbered 98.



As seen on the chart, the gold group has swung from approximately number 1 to near the low on the list during each year since 1968. Currently, as the dollar crisis continues, the gold group is picking up bullish momentum, and some time this year it should slip into the number 1 position.

Note the rising strength in Dome mines (a stock which moves in rather typical gold mine equity fashion). During late-1969 when the gold mining group dropped to 88 on the momentum index, Dome declined to the 47-50 range. During mid-1970 as the gold group touched the number 1 spot, Dome rose to the mid-50's.

In early 1971, with the gold mining group back in the 94 slot, Dome held above 55. Last week, with the gold group at 37th place, Dome was over 70. When and if the gold mining group moves into 1st place this year (as it has done for the past three years), Dome should make a try for its 1969 high of around 84.

Conclusion: With the gold group still far from first place, Dome is now well above its price of 1970 (when the gold group held in first place for week after week). This bodes well for the price of Dome and the other golds before 1971 is out.

LATE NOTES: Wednesday, May 12: Today, despite the "floating mark", the dollar continued on the weak side. Belgium called in $80 million more of U.S. gold, and the price of gold rose to $40.40, a new two-year high on the London market.

Meanwhile Germany has gone so far as to prohibit interest payments on foreign accounts held in Germany in a desperate attempt to halt the flow of dollars into Germany. But significantly (according to United Press), "By the close of business yesterday, dealers could detect no appreciable outward flow" (of marks). Translation: Interest or not, dollars are staying in Germany for safety reasons, and no amount of American propaganda or German penalties are going to disgorge those dollars.

The true and fundamental facts about the dollar crisis are a far cry from the rubbish and rot which has emanated from our Administration, Treasury and State Department. The fact is that this nation has lived "over its head" for decades, it has fought wars it could not afford and had not financed, it has encouraged its citizens to live way beyond their means, it has espoused debt as a benign way of life, it has engaged in the greatest spending and debt-creating "bender" in world history. Worst of all, it has convinced its citizens that this debt would never have to be paid off — only the interest would have to be serviced.

Now the once-mighty dollar is tottering, being turned in and sold off in every foreign market in the world. The dollar, which was once the rock-hard currency of the greatest nation in the world, is now a "soft currency", a currency which is bounced around and traded against hard currencies much like the fiat paper of any South American "banana republic".

History demonstrates that the rise and fall of a nation's currency closely reflects the rise and demise of a nation. The disciplines, industry and resolve which are needed to insure a strong currency reflect the character of the people themselves.

The decay which has overtaken the dollar corresponds in my mind with the greed, laziness and complacency which has become a trademark of the "middle generation" of the 1950's and 1960's. I'm part of that generation, but personally, I never felt much affinity for my generation. My hope and faith goes with the new generation, the under-25's, the ones who are asking the question, embarrassing the Congressmen and Senators, the ones who are showing the same courage now as my own generation once did when we stopped the Nazis and saw our blood and brains splattered in the air and on the ground from Rangoon to Rome.

In closing this, I want to say that I believe our hopes no longer lie with the oldsters, the flag-wavers of 50 or 60 who claim that "All we got to do is sit tight, and the boys in Washington will figure it all out and set us on the right path like they always done." Forget it! The path is changing, and readers of these Letters better believe it.

To my mind the "New Economics" (there's nothing really new about it) and the old, antiquated social values are blood brothers. They're both on their way <u>out.</u> Currently, we are seeing the collapse of the New Economics (Neo-Keynesianism) as the realitites of the market place grind these half-baked theories into the inevitable pre-depression slime. And with the downfall of the so-called New Economics will go the old or prehistoric non-human values — to be replaced (out of the agony of economic upheaval) by truths in human relationships, real emotions, values that rise above the split-level house, the 4,000 pound four-day sedan, the free-form swimming pool, the P.T.A. meeting that serves cookies and coffee and never says a thing about anything relative to what the kids are doing or thinking about.

Call this the comments of a crank if you want, but I think the stock market and the economy reflect the great tides of human affairs, the mighty plusses and the dismal minuses — and far before the mass of people fully comprehend what is happening in their own conscious mind. Everywhere I go I hear Americans complaining about the quality of life in this nation and the quality of their own life. The winds of change are blowing harder with each passing month, and all of us are going to have to learn new ways to think, to act, to live and to relate to each other.

And I guess the truth is that I've been one of the prime simpletons of all; I've been writing this Letter steadily for 14 years without a vacation, putting much too much <u>pressure</u> on myself. The time has come for me to take a tip from those younger souls who are in many ways much wiser than I. So I'm going to take my first vacation in 14 years. I'll be back within the next two or three weeks (I'll probably skip one or two Letters), and then I'll have a lot of exciting things to say about what's happening and what will be happening. Take my word for it, the era coming up is going to be the most dynamic and surprise-packed of any since World War II. I expect to make some changes in Dow Theory Letters to prepare my readers for those years. Oh yes — one more thought: If you think the whole answer is going to be merely to protect your financial nest egg, start re-thinking. The storms that are coming are going to be far greater than merely financial. I expect to talk about all this before the year is out.

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I thought this was a letter well worth reprinting (from W. P., Lake Worth, Fla.)

> Dear Mr. Russell:
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> From your recent letters I can see that you and Paul P. of Louisville, Ohio see some chance that we will come through all this into a new changed world of love and light. So I looked up the following bit of deathless prose which must have been dashed off by a politician, of all people around 1964.

The average life of each of the world's great civilizations has been 200 years, (some of them must have died in infancy) and during that life it has progressed through the following sequences:

1. from bondage to spiritual faith
2. from spiritual faith to courage
3. from courage to liberty
4. from liberty to abundance
5. from abundance to selfishness
6. from selfishness to complacency
7. from complacency to apathy
8. from apathy to dependency
9. from dependence back to bondage.....

In 12 years, the U.S.A. will be 200 years old. Based on what has been happening in this country for a great number of years, it would appear that we are in the 8th period mentioned above. (From Sen. Milward Simpson's Senate Report to Wyoming).

Regards,
Wallace P.

VERY LATEST NOTES: Thursday, May 13: Gold was fixed in London today at a new high of $40.80, almost $6.00 above the synthetic U.S. official price of $35 an ounce. Yesterday France tapped the U.S. for an additional $283 million in gold in part payment of its debt to the I.M.S. As I said in the last few Letters, it appears to me that the gold rush is on.